No. 86-1741 (2)

In the Supreme Court of the United States

OCTOBER TERM, 1986

T. J. MELTON, III AND ASSOCIATES, INC.,
ET AL., PETITIONERS

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly rejected petitioners' attempt to defeat their loan obligations to the Federal Deposit Insurance Corporation (FDIC) under notes acquired by the FDIC from a failed bank.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A5) is unreported. The opinion of the district court (Pet. App. C1-C16) is also unreported.

JURISDICTION

The judgment of the court of appeals was entered on December 29, 1986. The petition for a writ of certiorari was filed on March 28, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. This case arises from the failure of the First National Bank of Midland, Texas (FNB), on October 14, 1983. The same day, the Federal Deposit Insurance Corporation (FDIC) was appointed to be the receiver for the bank, and the FDIC arranged a purchase and assumption of FNB's assets. As part of that transaction, the FDIC, in its distinct corporate capacity, acquired a portion of those

assets, including two notes totalling more than $3.3 million executed in early 1980 by T. J. Melton, III and Associates, Inc. (Melton, Inc.), and guaranteed by, among others, T. June Melton, III, the petitioners here. Pet. 2; Pet. App. C3-C6.

For several months prior to the execution of the notes and guarantees, petitioners had negotiated with FNB to obtain funds to develop a water-theme amusement park (Pet. App. C2-C3). According to petitioners, FNB had agreed orally in November 1979 to their initial request for a $1,500,000 loan at 15% for six years, though the bank had requested additional information. Petitioners later increased their request to $1,700,000, but FNB, after receiving the requested information, indicated that it was not interested in lending money for a venture as speculative as an amusement park. In February 1980, FNB and petitioners agreed to loans, and signed notes, in the amount of $3,367,000 for a project that included the park and commercial and residential development. Pet. App. C3-C4.

Petitioners defaulted on their obligations under the notes in 1982. When FNB initiated foreclosure proceedings, petitioner Melton, Inc., immediately brought suit against the bank in Texas state court, alleging, among other things, that the bank breached the alleged November 1979 agreement, that the November 1979 agreement constituted fraudulent inducement for the February 1980 agreement, and that the February 1980 notes were executed under economic duress placed on petitioners by the bank's breach of the alleged November 1979 agreement to lend petitioners $1.5 million (Pet. 3-4; Pet. App. C5).[1] FNB failed in 1983, and the FDIC acquired the notes in its corporate capacity. The FDIC in its receivership capacity

[1] After the Texas court denied its motion for a temporary restraining order against the foreclosure, petitioner Melton, Inc., filed for bankruptcy, admittedly not because it was insolvent, but only to forestall the foreclosure (Pet. App. C5).

was substituted for the bank in petitioners' state-court action; the case was removed to the United States District Court for the Western District of Texas; and the FDIC in its corporate capacity filed a third-party complaint against petitioners and the other guarantors for the balance owing on the notes. Pet. 3.

2. The case was tried to a jury, which found in favor of petitioners and the other guarantors. The district court, however, found the jury verdict unsupported by the evidence and contrary to law on numerous grounds (Pet. App. C1-C16). The court therefore entered judgment for the FDIC notwithstanding the verdict (Pet. App. B1-B2).

The court first held that *D'Oench, Duhme & Co.* v. *FDIC*, 315 U.S. 447 (1942), barred petitioners' claims of fraud and breach of contract (Pet. App. C6-C8). By allegedly entering into an oral agreement, petitioners lent themselves to a transaction that was nowhere reflected in the bank's books and that, therefore, would tend to mislead bank examiners (*ibid.*). Under *D'Oench, Duhme & Co.*, the court held, petitioners were accordingly barred from raising the oral agreement against either the FDIC as receiver or the FDIC in its corporate capacity, even if the FDIC knew of the pending litigation when the bank failed (Pet. App. C8).

The court next held that 12 U.S.C. 1823(e) barred two defenses raised by petitioners and the other guarantors to the third-party claim made by the FDIC in its corporate capacity for the balance on the note (Pet. App. C8-C12). The first defense—that FNB breached various oral agreements, including the alleged November 1979 agreement—was plainly barred because the agreements met none of the requirements specified in the statute (*id.* at C9-C10). The second defense—fraud in the inducement—was likewise barred because it rested squarely on the claim that there was a secret side agreement (the bank's alleged

November 1979 oral agreement to lend petitioners $1.5 million) (*id.* at C10-C11).[2] The court also observed that the FDIC's knowledge of the claims against the bank at the time it acquired the notes did not affect the FDIC's entitlement to protection against such claims under Section 1823(e) (Pet. App. C11).

Having addressed the federal-law issues, the district court considered the state-law issues. The court set aside the jury finding of economic duress, ruling that, under Texas law, petitioners had failed to make out the defense (Pet. App. C12-C13). The court held that the bank's presentation of "take it or leave it" loan terms did not constitute economic duress for three reasons—the bank had a legal right to make the offer; petitioners, who took more than one month to review the offer and consulted an attorney, were not under imminent threat; and petitioners had ample opportunity to protect themselves by filing a lawsuit (*ibid.*). In addition, the court rejected as unsupported by the evidence the contentions that the bank breached the February 1980 loan agreement (*id.* at C13-C14) and that the guarantee signed by petitioner Melton was fraudulently induced (*id.* at C14-C15). The court further held that petitioners were estopped from denying the validity of the February 1980 loan agreement and that petitioner Melton, Inc., had ratified the actions of the bank by signing and later renewing various loan agreements (*id.* at C15-C16). Finally, the court held that relief to petitioners must be denied on the additional and

[2] The court pointed out that *Gunter* v. *Hutcheson*, 674 F.2d 862, 867 (11th Cir.), cert. denied, 459 U.S. 826 (1982), had stated that 12 U.S.C. 1823(e) does not bar a claim of fraud in the inducement based on fraudulent factual representations, as opposed to fraudulent promises. The district court noted that this case involves promissory fraud and therefore, even under *Gunter*'s analysis, is subject to Section 1823(e). Pet. App. C10.

independent ground that there was "no testimony that plaintiff suffered any damages as a result of the alleged fraud, breach of verbal agreement, economic duress or breach of contract" (*id.* at C16).

3. The court of appeals, in an unpublished opinion, "affirmed in all respects except for the denial of attorney fees to the FDIC in its corporate capacity" (Pet. App. A2). The court first held that petitioners' (and the other guarantors') defenses against the FDIC in its corporate capacity, which were based on oral agreements not recorded in the books or records of the insured bank, were barred by 12 U.S.C. 1823(e), irrespective of any knowledge of the defenses the FDIC may have had upon acquiring the notes (Pet. App. A2). The court also rejected petitioners' claims against the FDIC as receiver: the court held that petitioners wholly "failed to prove reasonably certain damages caused by any failed promise or wrong of FNB" (*id.* at A3). See *ibid.* (even assuming some economic duress, petitioners did not prove damages from the duress; "certainly there is no proof of [petitioners'] damages caused by culpability of the bank"); *id.* at A4 (petitioner Melton, Inc., "may have suffered damages because [it] did not get the $1.5 million loan, but [it] has made no attempt to prove what they were"). Finally, the court of appeals held that petitioners failed to show any breach by the bank of the February 1980 agreement (*id.* at A4-A5) and that the district court had erred in denying the FDIC attorney's fees (*id.* at A5).

ARGUMENT

Although petitioners raised many claims and defenses in the courts below, they[3] present only one question in this Court—whether 12 U.S.C. 1823(e) bars their defense of

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[3] Aside from petitioner Melton, the guarantors on the note have not petitioned for review of the court of appeals' decision.

economic duress to the note held by the FDIC in its corporate capacity. Petitioners' request for this Court's review on that question is patently without merit.

1. The question presented by petitioners was not ruled on by the lower courts or raised by petitioners in the court of appeals. Neither the court of appeals nor the district court held or stated that, or even considered whether, Section 1823(e) bars the defense of economic duress. The district court rejected the economic duress defense without reaching the question whether the defense was barred by Section 1823(e). Accordingly, the court of appeals had no occasion to address the question, and it did not do so. Likewise, petitioners had no occasion to raise the question in the court of appeals, and they did not do so. Rather, the district court and the court of appeals ruled only that Section 1823(e) barred petitioners' breach-of-contract and fraud defenses, rulings that petitioners do not challenge here. Pet. App. A2, C8-C12; 85-1331 & 86-1285 Appellants' Br. In sum, there is no lower-court ruling on petitioners' contention for this Court to review, and the question presented is not in the case.

2. The district court found that petitioners had wholly failed to prove economic duress (Pet. App. C12-C13). Although petitioners challenged that finding on appeal, the court of appeals affirmed the district court's judgment "in all respects" (Pet. App. A2). Not surprisingly, petitioners do not ask this Court to review the finding that they failed, under standards defined by Texas law, to make out the defense (see Pet. i (Questions Presented); Pet. 11-14).[4] Thus, petitioners' economic duress defense

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[4] Petitioners do not contest the district court's view of the requirements of economic duress under Texas law (Pet. 11-13; Pet. App. C12; 85-1331 Appellants' Br. 20 ("Melton, Inc. takes no issue with the trial court's analysis of the legal requirement to establish economic duress.")). The rejection of the defense, for the reasons given by the district court (Pet. App. C12-C13), is obviously correct.

has already been fully considered and finally rejected. Any ruling by this Court on petitioners' contention that 12 U.S.C. 1823(e) permits them to prove economic duress could have no effect on the judgment in this case.

3. Even if petitioners' contention concerning 12 U.S.C. 1823(e) were properly before this Court, review still would not be warranted. Not even petitioners contend that there is a conflict among the lower courts on whether Section 1823(e) bars a defense of economic duress. Moreover, a ruling against petitioners on that question, if one existed, would be correct.

As petitioners concede (Pet. 9), their economic duress defense was premised on the alleged November 1979 oral agreement by the bank to lend them $1.5 million, an agreement petitioners allegedly relied on and the bank allegedly broke. Section 1823(e), which by its terms declares any such oral agreement not to be "valid against the [FDIC]," was designed to protect the FDIC and its insurance fund (and hence depositors nationwide) against any agreements that are not reflected, in a carefully prescribed manner, in the books and records of the insured institution. The provision enables the FDIC to rely on bank records both in examining insured banks for soundness and in determining with necessary expedition how to deal with a failed bank.[5] The alleged undisclosed November 1979 loan

[5] When a bank is closed by its chartering authority, the FDIC must determine whether to liquidate the bank and pay the insured statutory amounts from the Permanent Insurance Fund (12 U.S.C. 1821(f)) or to take the less drastic step of arranging a purchase and assumption transaction (12 U.S.C. 1823(c)(2)(A)), which ordinarily results in a reopening of the failed bank the next business day and the full protection of all depositors of the bank (see *Gunter* v. *Hutcheson*, 674 F.2d 862, 865-866 (11th Cir.), cert. denied, 459 U.S. 826 (1982)). Which course to take must be decided "with great speed, usually overnight" (674 F.2d at 865). By statute, the FDIC generally may choose the preferred purchase-and-assumption option only if the costs to the Permanent Insurance Fund are less than they would be in a straight

promise by the bank, which petitioners could readily have insisted be placed in writing in accordance with the terms of Section 1823(e), is precisely the sort of agreement the statute permits the FDIC to ignore. See *Black* v. *FDIC*, 640 F.2d 699 (5th Cir.), cert. denied, 454 U.S. 838 (1981); *FDIC* v. *Hatmaker*, 756 F.2d 34 (6th Cir. 1985); *FDIC* v. *Lattimore Land Corp.*, 656 F.2d 139 (5th Cir. 1981); *FDIC* v. *Rodenberg*, 571 F. Supp. 455 (D. Md. 1983); *FDIC* v. *Kucera Builders, Inc.*, 503 F. Supp. 967 (N.D. Ga. 1980).[6] If some loss results from such an agreement, Section 1823(e) requires that it be borne not by the FDIC fund but by the parties who were in a position to have protected themselves.[7]

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insurance payoff (12 U.S.C. 1823(c)(4)(A)). Because of the speed with which that cost determination must be made, the ability to rely on bank records, and to avoid inquiries into court documents, state law, and other matters outside bank records, is critical to the FDIC's performance of its functions.

Here, the closure of the bank and the consummation of the purchase-and-assumption transaction both took place on October 14, 1983 (Pet. App. C5).

[6] See also *FDIC* v. *O'Neil*, 809 F.2d 350 (7th Cir. 1987) (Section 1823(e) bars debtor's claim that an unexecuted side agreement referred to in his note could be used as a defense against the FDIC); *Public Loan Co.* v. *FDIC*, 803 F.2d 82 (3d Cir. 1986) (Section 1823(e) bars claim of accord and satisfaction); *FDIC* v. *Fonseca*, 795 F.2d 1102 (1st Cir. 1986) (Section 1823(e) bars defense that debtor never received consideration for the loan); *FDIC* v. *Castle*, 781 F.2d 1101 (5th Cir. 1986) (Section 1823(e) bars partners' claim that they were to be collectively liable for only a portion of the debt); *FDIC* v. *Merchants Nat'l Bank*, 725 F.2d 634 (11th Cir.), cert. denied, 469 U.S. 829 (1984) (Section 1823(e) bars claim that loan participation did not fully reflect the agreement between the banks); *Chatham Ventures, Inc.* v. *FDIC*, 651 F.2d 355 (5th Cir. 1981), cert. denied, 456 U.S. 972 (1982) (Section 1823(e) bars assertion that bank breached a joint venture agreement); *FDIC* v. *Hoover-Morris Enterprises*, 642 F.2d 785 (5th Cir. 1981) (Section 1823(e) bars claim that bank agreed not to seek a deficiency judgment).

[7] Here, of course, a "loss" is not at issue in the dispute between petitioners and the FDIC in its corporate capacity. All that is at issue is the

Use of an oral agreement to invalidate written obligations—here, petitioners' attempt to invalidate the written notes on the ground of economic duress caused by the bank's failure to live up to its alleged November 1979 agreement—would just as surely defeat the statutory protection of the FDIC as direct assertion of the validity of the oral agreement. The lower courts uniformly recognize this point.[8] Petitioners seek support for the contrary suggestion (Pet. 5-11) in two decisions concerning a fraud-in-the-inducement defense to a note (*Gunter* v. *Hutcheson,* 674 F.2d 862 (11th Cir.), cert. denied, 459 U.S. 826 (1982); *FDIC* v. *Hatmaker, supra*). Those decisions, however, merely suggest that where a claim of fraud is premised on *factual* misrepresentations, Section 1823(e) is inapplicable because no "agreement" is involved. As even petitioners acknowledge (Pet. 8), the cited decisions recognize that, if a *promise* is the basis of the fraud allegation, then an "agreement" is involved, and Section 1823(e) bars a fraud-in-the-inducement defense just as it bars assertion of the promise as itself a valid agreement (*Gunter,* 674 F.2d at 867; *Hatmaker,* 756 F.2d at 36-37).[9] The alleged agree-

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FDIC's attempt to recover from petitioners funds they received from the bank under the February 1980 loan agreement.

[8] See *FDIC* v. *Armstrong,* 784 F.2d 741 (6th Cir. 1986); *FDIC* v. *Castle,* 781 F.2d 1101 (5th Cir. 1986); *FDIC* v. *W.H. Venture,* No. 84-5673 (E.D. Pa. May 22, 1986); *FDIC* v. *Vestring,* 620 F. Supp. 1271 (D. Kan. 1985). See also *FDIC* v. *O'Neil,* 809 F.2d 350, 354 (7th Cir. 1987); *FDIC* v. *Lattimore Land Corp.,* 656 F.2d at 146 n.13 (fraudulent inducement defense would permit "an end run around § 1823(e)"); *FDIC* v. *Rodenberg,* 571 F. Supp. 455, 459 (D. Md. 1983) ("To permit the defendant to raise these representations in a defense of fraudulent or negligent misrepresentations—while barring their admission as collateral agreements—would allow the defendant to make an 'end run' around § 1823(e).").

[9] Petitioners also cite *FDIC* v. *Balistreri,* 470 F. Supp. 752 (E.D. Wis. 1979), for the proposition that "[t]he affirmative defense of economic duress is closely akin to that of fraud in the inducement"

ment underlying petitioners' defense is a promise to lend money, not a factual misrepresentation (Pet. App. C10-C11). Thus, the decisions on which petitioners rely plainly support rejection of petitioners' defense.

Similarly, the courts of appeals have uniformly rejected the argument made by petitioners (Pet. 14-18) that 12 U.S.C. 1823(e) should not apply where the FDIC has knowledge of a debtor's defense. *FDIC* v. *O'Neil, supra; FDIC* v. *Merchants Nat'l Bank,* 725 F.2d at 640; *FDIC* v. *de Jesus Velez,* 678 F.2d 371, 375 (1st Cir. 1982). The *Gunter* decision, as the excerpt quoted by petitioners shows (Pet. 14), is not to the contrary: the court there stated that the FDIC's knowledge of defenses was relevant, not under Section 1823(e), but under federal common law.[10] The courts' unanimity on this issue is hardly surprising, since there is no suggestion of a knowledge exception in the language of Section 1823(e). The statute, indeed, is explicit in its requirements that an enforceable agreement be written "contemporaneouly" with the creation of the asset involved and be reflected "continuously" on the bank's records from its inception, requirements plainly designed to enable bank regulators to be aware *at all times* of any agreement that would diminish the value of a bank asset. Accordingly, the protection of the statute does not disappear if, for example, the FDIC happens to learn of an off-the-books agreement during the few hours when it is determining how to deal with a failed bank.

4. For all of the above reasons, review by this Court of the decision of the court of appeals would be inappropriate. Nor should the petition be held pending this

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(Pet. 6). *Balistreri* held, however, that Section 1823(e) protects the FDIC in its corporate capacity against fraud-in-the-inducement defenses (470 F. Supp. at 756-757).

[10] Moreover, *Gunter* found the FDIC protected under federal common law (674 F.2d at 868-874). Accord, *FDIC* v. *Armstrong,* 784 F.2d 741 (6th Cir. 1986).

Court's decision in *Langley* v. *FDIC,* cert. granted, No. 86-489 (Jan. 12, 1987), in which debtors contend that 12 U.S.C. 1823(e) does not bar defenses of fraudulent inducement based on a bank's false factual representations. The *Langley* case focuses on the distinction between promissory and factual fraud, as to which there is some disagreement among the courts of appeals. The instant petition, as we have explained, does not properly present any issue concerning Section 1823(e) for decision. Moreover, the basis for petitioners' defense here is a promise, not a factual misrepresentation; and there is no conflict over Section 1823(e)'s application to such a defense.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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